

INTRODUCTION

On Tuesday, September 28, 2004, the Assembly Committee on Revenue and Taxation held an informational hearing on jet fuel sales tax policy. The hearing was held in Room 358 of the San Diego County Administration Building from 11 a.m. to 1 p.m. Approximately twenty-five people attended the hearing.

Two Assemblymembers heard testimony from thirteen witnesses. Members who participated in the hearing included:

Assemblyman Rudy Bermudez, Chair, Revenue and Taxation Committee
Assemblyman Gene Mullin, Chair, Select Committee on Airports and the Airline Industry

This final report contains the committee staffs' summary of the testimony offered during the hearing and reproduces written testimony submitted by the witnesses. The report also reprints the background paper written by staff before the hearing.

THE WITNESSES

Mr. Dan Cady, Board of Equalization*

Mr. Dave Hayes, Board of Equalization*

Dr. Mark Ibele, Principal Fiscal and Policy Analyst, Legislative Analyst's Office (testimony read by Revenue and Taxation Committee Staff Eileen Roush in Dr. Ibele's absence)*

Mr. Jim Hultquist, Air Transport Association*

Mr. Robert Gransee, United Airlines*

Ms. Rose Valintinetti, Southwest Airlines*

Mr. Robert Glenn, American Airlines and American Eagle

Mr. John Miller, America West

Ms. Bev Hansen, on behalf of both Jet Blue* and the Air Transport Association

Mr. Dwight Stenbakken, League of California Cities

Ms. Jean Hurst, California State Association of Counties*

Ms. Casey Kaneko, Urban Counties Caucus

* Written materials provided by this individual are reproduced on subsequent pages.

Speaking During Public Comment Period:

Mr. Mitch Devlin, Orange County

Mr. Jose Luis Sanchez, Southwest Airlines

INFORMATION PRESENTED

The hearing began with an introduction and series of welcoming remarks from both Assemblyman Bermudez and Assemblyman Mullin. It continued with brief presentations from representatives of the Board of Equalization, who discussed the history of state sales tax policies regarding jet fuel and presented historic jet fuel price, consumption, and sales tax data. Revenue and Taxation Committee staff read from a paper prepared by the Legislative Analyst's Office regarding options for changing the way in which the state imposes sales tax on commercial jet fuel. Representatives of the airline industry and local governments then concluded with a lengthy discussion of the pros and cons of altering the state's jet fuel sales tax policies.

Opening Remarks, Assemblyman Rudy Bermudez: Chairman Bermudez welcomed the hearing's attendees and thanked them for coming. In his remarks, he noted that the September 28th hearing would be one of two that the Assembly Revenue and Taxation Committee planned to hold on the subject of jet fuel taxation. The Chair asserted that the Legislature has an obligation to examine our tax policy as it relates to jet fuel and see whether there are changes we can make that will help the airline industry and generate positive results for both the state and for local governments. He expressed his intention to fully vet the issues surrounding jet fuel and to address every issue in a fair manner. He noted that there is plenty of time to make necessary changes and stressed that the outcome of these hearings will result in legislation that will be beneficial to the airline industry.

Chairman Bermudez deferred any discussion about local jet fuel sales tax allocation issues until a later hearing in northern California. Instead, he announced his desire to focus the September 28th hearing on changes the airline industry would like the Legislature to make to the state's jet fuel sales tax policy. He noted that the airline industry plays a key role in the economy of our state. It creates and maintains jobs and is a vehicle for moving goods and people, but it is currently dealing with the high costs of jet fuel, security, and technology. He asserted his belief that the Legislature needs to look at ways of increasing the stability and viability of airlines without creating a negative impact on the budgets of local governments. However, he did stress that local governments benefit from the airline industry and need to be invested in the health of the airlines.

Opening Remarks, Assemblyman Mullin: Assemblyman Mullin also thanked attendees for coming and expressed his appreciation for being able to participate in the hearing. He

echoed the spirit of Chairman Bermudez' comments by noting that the relationship between airports and their surrounding communities is a balancing act. Communities near airports deal with noise, air pollution, and traffic impacts. However, airports are large employers and serve a very valuable public function.

Dan Cady and Dave Hayes, Board of Equalization: See written testimony, reproduced immediately following this section.

Mark Ibele, Legislative Analyst's Office: See written testimony, reproduced immediately following this section.

Airline Industry Representatives: The majority of the comments and suggestions offered by representatives of the airline industry are contained in their written testimony which is reproduced immediately following this section. However, a handful of points made by the airline industry stand out.

- First, the airlines are on the brink of financial disaster.
- Second, jet fuel prices represent a very significant expense for the airlines. The price of jet fuel is at an all-time high, which has placed a significant amount of financial pressure on an industry already reeling from the effects of September 11th.
- Third, the high costs of jet fuel nationwide are magnified in the west. Nearly all of the airline industry representatives testified that jet fuel is more expensive on the west coast than elsewhere in the country, due in part to the market's ability to bear the higher prices and in part to limited regional jet fuel production.
- Fourth, the high cost of jet fuel in the west combined with California's sales tax policies cause all carriers to "ferry" or "tanker" fuel into California. Ferrying or tankering is the practice of carrying more fuel than is necessary to reach a given destination in order to reduce the amount of fuel purchased at that destination. An example of tankering is as follows: Airline A plans to fly from Phoenix to Los Angeles, and back to Phoenix. Airline A takes on more fuel than it needs in Phoenix, because the airline calculates that it saves enough money in taxes on the fuel it purchases in Arizona to fully offset the cost of flying heavier (with more fuel than necessary) to California.

All of the airline industry representatives urged the state to lower the sales taxes imposed on jet fuel purchases made in California.

Local Government Representatives: Like representatives who testified on behalf of the airline industry, all of the local government representatives were consistent in their testimony.

- They were unanimous in their agreement about the importance of the airline industry to California and in their desire to work with the Committee to craft a tax policy

solution that benefits all parties.

- However, they also stressed the significant fiscal hardships experienced by local governments throughout California over the past several years and urged the Committee to craft a solution that did not further reduce local government revenues. They noted that even if Proposition 1A on the November ballot passes, local governments will be giving up \$2.6 billion over the next two fiscal years, on top of their losses due to the ongoing Educational Revenue Augmentation Fund shift.

The Chair urged all of the local government representatives to consider the extent to which they benefit from the presence of airports and to view any solution benefiting the airports as helping them by shoring up the health of an industry on which local governments rely.

- Local government representatives agreed that airports generate local revenue, but also noted that local governments incur costs to provide the infrastructure used by the airlines and undertake many of the security costs associated with operating in the post-September 11th environment.
- The local government representatives urged the Committee to craft a solution that did not constrain local flexibility or sever the close fiscal relationship between airports and the jurisdictions in which they are located. Dwight Stenbakken, in particular, speaking on behalf of the League of California Cities, stated that solutions which are crafted locally are usually better than a state-imposed, cookie-cutter approach. He urged the state to retain the connection between tax policy and local goals and strongly encouraged the state to continue allocating local sales tax revenue on a situs basis.

Public Comment Period: Mitch Devlin, speaking on behalf of Orange County, urged the Committee to consider that the high cost of jet fuel is a national issue, not a state or local issue. He asserted that there are no guarantees that anything the state does will keep the airlines afloat. He suggested that the Committee obtain information regarding the regional prices of jet fuel ex-tax in order to gauge the effect that California could have on jet fuel costs.

Closing Remarks, Assemblyman Rudy Bermudez: Chairman Bermudez thanked everyone for coming and for participating. He also reiterated that because of his background as both a school board member and a city council member, he understands the nexus between services provided by local governments and their cost recovery. He expressed strong support for the fiscal health of local governments but urged the local government representatives in attendance to consider that their revenues are directly tied to the financial solvency of the airline industry. He also reminded the audience that he would be convening a second hearing on jet fuel sales tax policy in northern California this fall.